



## THE EXPANSION RETAINS MOMENTUM

### Overview

Economic growth was robust in the 3<sup>rd</sup> quarter, and is expected to continue at a healthy pace, despite a slight hurricane-induced drag on employment and production in the near term. Payroll employment showed a modest gain in October, but business activity in the manufacturing and services sectors still appears to be increasing at a solid pace. The economic expansion has contributed to a considerable rise in Federal tax receipts in fiscal year 2005. Energy prices have continued to ease from the spikes generated after Hurricane Katrina struck.

### Highlights

- The inflation-adjusted (real) gross domestic product [GDP] grew at a robust 3.8 percent in the 3<sup>rd</sup> quarter. Forecasters see a slight dip in growth in the 4<sup>th</sup> quarter, reflecting hurricane effects, followed by a return to stable healthy growth throughout next year (see Fig. 1).
- Payroll employment grew by 56,000 jobs in October (see Fig. 2, next page), somewhat less than the average of nearly 170,000 a month for the past year. Nevertheless, the unemployment rate edged down from 5.1 percent to 5.0 percent in October.
- Energy prices have continued to recede from their post-Katrina peaks, but remain elevated. Crude oil has fallen by around 15 percent from the early-September high of nearly \$70 a barrel.

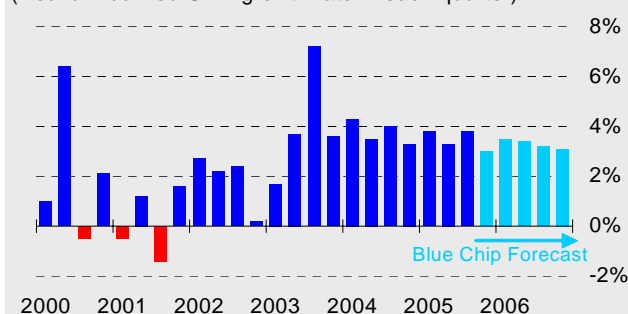
### Growth Expected to Remain Healthy

Forecasters continue to project healthy growth and relatively low inflation. The *Blue Chip* consensus forecast is for annualized growth in real GDP, a broad measure of the Nation's output of goods and services, to slow to a still-healthy 3.0 percent in the 4<sup>th</sup> quarter, reflecting effects of the hurricanes. Growth is then expected to remain above 3.0 percent throughout 2006.

### Economic Growth Since 2000

(Real annualized GDP growth rate in each quarter)

Fig. 1



Sources: Bureau of Economic Analysis

### Blue Chip Economic Outlook, November 2005

	2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Actual				Projection			
Real GDP Growth	3.8	3.3	3.8	3.0	3.5	3.4	3.2	3.1
Unemployment Rate	5.3	5.1	5.0	5.1	5.0	5.0	5.0	5.0
CPI Inflation	2.5	4.0	5.3	4.0	2.5	2.3	2.3	2.3
3-month Treas. Bill	2.5	2.9	3.4	4.0	4.3	4.4	4.5	4.4
10-year Treas. Note	4.3	4.2	4.2	4.6	4.8	4.9	5.0	5.0

The robust growth in GDP in the third quarter was led by consumer spending, business investment in equipment and software, Federal Government spending, and residential investment. Inventory investment declined for the second consecutive quarter as businesses met demand by drawing down inventories. This bodes well for future growth as businesses produce more to restock their shelves.

There have now been 10 uninterrupted quarters of real GDP growth above 3.0 percent, the longest such stretch since the 13 quarters that ended in the 1<sup>st</sup> quarter of 1986.

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## Jobs Increase, Unemployment Edges Down

October's modest payroll employment gain of 56,000 jobs followed a significant downward revision of September's job losses – to just 8,000, from the previous estimate of 35,000. The Bureau of Labor Statistics [BLS] has concluded that September's weakness was "largely due to the job loss in areas devastated by Hurricane Katrina." The BLS also found that payroll job gains outside the disaster areas was in line with a monthly employment gain for the Nation of around 200,000 in September. Combining the two figures, a rough gauge of the effect of Hurricane Katrina on national employment is a net loss of about 208,000 jobs in September. The relatively mild gains in payroll jobs in October was not attributed by the BLS to areas directly affected by Katrina.

Even with the September job losses, more than 4.2 million new jobs have been added to payrolls over the past 29 months, and more than 1.6 million have been created this year. The unemployment rate – which edged down to 5.0 percent in October, from September's 5.1 percent – remains well below the average of each of the past three decades, which ranged from 5.8 percent to 7.3 percent.



## Expansion Continues in Manufacturing, Services

The Institute for Supply Management [ISM] index of manufacturing activity fell slightly to 59.1 in October, from 59.4 in September, but continues to show a vibrant pace of expansion in manufacturing. An index value above 50 indicates expansion in the manufacturing sector; 60 indicates vibrant expansion. The ISM manufacturing index has been above 50 for 29 consecutive months. The ISM index of service-sector activity rebounded to 60.0 in

October, after having fallen to 53.3 in September, indicating renewed strength in the services sector. The index has indicated expansion in this sector of the economy for 31 consecutive months.

## Federal Tax Receipts Have Surged

Federal tax receipts increased by nearly 15 percent in fiscal year 2005 (which ended on 30 September 2005), reflecting sizable gains in corporate income tax receipts (up 47.0 percent over fiscal year 2004) and in individual income tax receipts (up 14.6 percent over fiscal year 2004). As a result, despite significant growth in Federal Government spending, the unified budget deficit fell to \$319 billion, close to \$100 billion less than the figure for fiscal year 2004 and much smaller than deficit projections earlier in the year.

## Energy Prices Ease, but Remain Elevated

Futures prices of crude oil have fallen by about 15 percent since a high of nearly \$70 a barrel in early September. Gasoline futures prices have fallen by around 35 percent from a record high set on 31 August 2005, and are now at levels not seen since the beginning of summer. At the pump, regular unleaded gasoline prices averaged \$2.30 across the Nation last week, down 25 percent from record highs above \$3.00 in early September. Heating oil futures prices have fallen by around 20 percent from the post-Katrina high of \$2.22 per gallon set in early September. Natural gas prices remain elevated, but have fallen by 19 percent since a high of close to \$14 per million British thermal units set in early October, after Hurricane Rita struck.

## Fed Likely to Continue Raising Rates

The Federal Reserve has raised its target overnight interest rate from 1.00 percent to the current 4.00 percent in a sequence of quarter-point increases that began at the end of June 2004. Since May 2004, the Fed has stated that "policy accommodation [keeping interest rates low to accommodate increased economic growth] can be removed at a pace that is likely to be measured."

The "measured pace" language indicates that further increases in short-term interest rates are likely in the future. The Fed believes that elevated energy prices and disruptions in economic activity because of the hurricanes have dampened output and employment in the Nation, but that the effects do not pose a persistent threat. The next Fed policymaking meeting is scheduled for 13 December 2005.

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